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UNCLAS SECTION 01 OF 07 SANTO DOMINGO 003864

SIPDIS

SENSITIVE

DEPT FOR WHA/CAR (SEARBY), DEPT PASS TO SEC, FEDERAL RESERVE; TREASURY FOR WAFER, DOJ FOR OIA (MAZUREK AND ORJALES)

E.O. 12958: N/A

TAGS: DR EFIN KJUS PGOV PREL

SUBJECT: DOMINICAN BANKING #9 -- MEJIA SAYS "BANKING FRAUD" RIGHT OUT LOUD

REF: 05 SANTO DOMINGO 3723

¶1. (SBU) This is number 9 in a series of cables on consequences of the Dominican bank failures of 2003.

Dominican Banking Series #9 -- Mejia Says It Right Out Loud: "Banking Fraud"

More than a year of virtual silence on Dominican banking frauds has ended with Hipolito Mejia's erudite, detailed and dignified public rebuke to Leonel Fernndez. Mejia's 15 page letter, sent on July 29 and published as a paid advertisement on July 31, cites extensively texts of reports and remarks by the IMF, reputable bank analysts, the Inter-American Development Bank, the UN Development Program, U.S. Treasury Under Secretary John Snow, ambassadors accredited to Santo Domingo, and Dominican civic organizations, then explains and defends his economic management, and concludes with a statesmanlike offer to cooperate in the national interest and to assure that his party, the PRD, does so as well.

The case against Baninter owner and executive Ramon Baez Figueroa has been kept out of the public eye almost since Figueroa was set free on a bail pledge on Christmas Eve, **¶12003**. Investigating magistrate Eduardo Sanchez Ortiz took more than nine months to assemble the elements for the formal charge, operating as the sole investigator and shaper of the case under the former Napoleonic Criminal Procedures Code; Baez's attorney Vincio "Vinch" Castillo stalled procedures for nearly a year by petitioning for removal of the president of the three-judge panel charged with assessing the recommendations of Sanchez Ortiz. That motion was denied on March 28 of this year, allowing the judicial process to continue.

Any news item ages, but the long absence of the Baninter case from public discourse and from the media has been of particular concern. The Fernandez administration consistently avoided comment both in public and with the Ambassador and staff in private, commenting simply that the matter was with the courts. There has been little movement in the Bancredit case of Arturo Pellerano, suspended in November 2003 apparently out of deference to the Pellerano family; in the Banco Mercantil case one individual, Andres Aybar, was arrested and charged on June 14, 2005.

The impression left by this relative silence was that Bez and his associates were being left to bribe, influence and intimidate their way out of the charges, and that these important cases would face the oblivion characteristic of all corruption cases in Dominican justice over the last twenty years. The only counter indication to this has been the Central Bank's dogged pursuit of Luis Alvarez Renta in the civil courts in Miami, despite the recommendation by Snchez Ortiz that Alvarez Renta not face criminal charges in the Dominican Republic.

In this setting, in his extempore public remarks in May and June Fernandez had on several occasions blamed the financial and economic crisis of 2003-2004 on Mejia "mismanagement" of the economy, while conspicuously omitting any mention of bank frauds. This appeared to be one more indication that the cases were slipping away.

Hipolito Mejia had remained low profile for the May-June PRD party consultations, which resulted in the election of his ally Ramon Albuquerque to head the party. This was unlike the brash, rough, comic speaker during the 2004 presidential campaign, capable of goading candidate Fernndez for wearing "panties" and spending all his time on the Internet. But the letter Mejia sent to Fernandez last Friday, in addition to assuming the newly dignified stance of a statesman, did the country the service of documenting the belief of the community of experts and international institutions that fraud at Baninter and other banks was the greatest proximate cause of the nation's misery in 2003-2004, and that the fraud had been undetected or not pursued until the pyramid accounting schemes collapsed in late 2002.

Mejia's document is specific, extensive, sober, and well reasoned. His dignity and espousal of the national interest raise his profile sharply and stand in strong contrast to the glib, relatively slippery "big picture" analysis that Fernandez spins out on public occasions and in private. The inept drafting of the constitutional amendment of 2002 leaves Mejia ineligible to present himself as a presidential candidate once again; if that were not the case, his July 29 letter would have established a platform for a new presidential bid. He belied the tone somewhat during a television interview on August 1 in which he groused in his more characteristic style about the ineptitude of the Fernandez administration.

Fernandez was in Panama for a regional summit when the letter arrived. Presidential legal advisor Cesar Pina Toribio and the presidential press spokesman replied to journalists that the administration is not in any way interfering with the courts - partial and insufficient replies to Mejia's theses. In El Caribe of July 31 senior columnist Miguel Guerrero regretted that the administration had not waited to reply to Mejia until President Fernandez could evaluate the former president's reasoning and his offer to assure that his party in Congress supports measures in the national interest.

In the meantime, as the papers are playing up the Justice Ministry's semi-annual report on homicides and decrying gang violence, last week's sicario-style hit against Ramon Baez's former assistant was a disquieting indication that white collar crime might not be as bloodless as it appears. Angel Miguel Antonio Bello Perez was driving along the 27 of February elevated roadway in the center of town at night when several individuals pursued him and riddled him and his pickup truck with bullets as he tried to elude them and maneuver out of the road's narrow chute. The police have told the public that Bello had just exchanged a large sum of cash at an exchange house and was the victim of a robbery attempt. Their theory does not account for the violence of the attempt or the fact that it was carried out in such a precarious and public place.

12. (U) Drafted by Michael Meigs.

13. (U) Appendix: Informal translation of the concluding pages of Mejia's letter of July 27 to Leonel Fernandez.

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Mr. President: From the analysis by international experts, multilateral financing organizations, international entities which provide follow-up to the development of the nations of the world and the region, by the United States Department of the Treasury, representatives of foreign governments in our country, officials of its own government, and the Association of Banks of the Dominican Republic, one can conclude that:

- a) The banking crisis was the result of a fraud to benefit the owners or companies and persons linked to the banks that caused the crisis.
- b) The fraud occurred over an extended period of time which included not only the first two years of my administration, but also the four previous years presided over by you.

In this regard, you can ask the Governor of the Central Bank to send you the documentation where it reveals that in the case of Baninter, the fraud began to take shape in 1989.

c) The banking supervision before the crisis exploded was very deficient. This includes the supervision of the last fifteen years, which includes the four years of the government which you presided over from 1996 to 2000. It was during my government that the bank fraud was discovered and, once proven/confirmed, we acted in consequence, submitting to the justice system those responsible for same.

d) Those responsible for the fraud managed to outwit not only the supervisory authorities but also the monetary authority of the country. Well-known international firms such as PriceWaterhouseCoopers were also fooled, despite the fact that they have more qualified technical resources than those which the Superintendency of Banks of the Dominican Republic has generally had. The present Governor of the Central Bank could send you a copy of the letter sent by PriceWaterhouseCoopers to the President of Baninter, in which it reveals that that firm of external auditors was also fooled by the executives of that bank.

e) Almost all of the experts and entities mentioned acknowledged that the decision to rescue the depositors of the banks which had been fraudulently bankrupted was taken given the perception that if that had not been done, the rest of the banking system could have been affected, giving rise to a systemic crisis that would cause the payment system to collapse. The present authorities of the Central Bank could confirm to you whether it is true or not that 19 savings and

loan associations and 3 multi-banks had substantial deposits in Baninter and several pension funds, retirement plans, as well as deposits of foundations, non-governmental organizations, and churches. (sic)

f) The economic and financial crisis of 2003, which was manifested in the form of a heavy devaluation, accelerated inflation, an increase in the deficit of the public sector due to the arising of a considerable quasi-fiscal deficit of the Central Bank, a loss of reserves, an increase in the public debt, and economic stagnation, was unleashed by the banking crisis, and not the reverse, as you and some of your functionaries have indicated. None of the experts and entities mentioned has stated that in 2001 and 2002 the country was immersed in an economic crisis.

g) The bank frauds were what caused an intense wave of uncertainty and distrust, which led to a greater dollarization and flight of capital. The mistrust and uncertainty, therefore, were not produced by the economic policy of 2002-2003 but rather by the uncovering of the enormous bank fraud, which (sic)

h) both the IMF and the Dominican government considered that it should be made known to the entire country, to establish clearly that those responsible for the bank frauds would have to pay for the consequences of their actions under the terms established by the Dominican justice system.

i) Abiding by the formulas for liquidation and dissolution provided by the Monetary and Finance Law, in the opinion of experts, was not feasible in the case of the collapse of the largest bank in the country, if one wanted to avoid a domino effect which would infect the rest of the system's banks. For that reason the IMG required the approval of a complimentary Law (the law of Exceptional Program of Prevention of Risk for Financial Intermediation Entities) to the Monetary and Finance Law, because the latter did not contemplate the occurrence of situations such as the one presented in the Dominican Republic in 2003.

j) The decision in 1996 to sell the Banco del Comercio Dominicano to Baninter, when the latter had already been violating banking norms for seven years with the so-called parallel bank that was hiding in accounts under the title of &interbank,⁸ unfortunately, constituted an incorrect decision. If memory does not fail me, I believe that it was in mid-1997, when you were the President of the Republic, that Baninter acquired the Banco del Comercio Dominicano, a bank with serious problems of liquidity and solvency, which before being handed over to Baninter, was cured by the Central Bank.

The hypothesis which you and some of your functionaries, specifically the President of the Board of Economic Advisers and the Secretary of State for Finance, hold that it was the economic policy carried out in the first two years of my government which caused the banking crisis that the country faced in 2003 has disturbed not only Dominican society but also governmental, multilateral, financial, and international economic circles.

The astonishment has been enormous, as all the evidence and analysis of international experts, of multilateral financing entities leave no doubt that the cause of the banking crisis was a fraud that had been taking place since 1989 and which began to have repercussions in August of 2002, exploded in April of 2003, and was made known to all of the country in May of 2003.

Baninter began to face liquidity problems in August-September of 2002. In case you do not remember, the Dominican economy was growing at a relatively high rate during the first half of the year 2002, amounting to 7.3%. The deficit of the consolidated public sector was 2.2% of the GNP, less than the 4.3% that you handed over to me in August of 2000. The deficit of the current account of the balance of payments was 4.3% of the GNP during the first 9 months of 2002, less than the 6.7% that you handed over to me in August of 2002.

In August of 2000 you handed over to me an economy with an exchange rate of RD\$16.50 per dollar. In August of 2002, that is to say, two years later, the exchange rate was RD\$18.46 per dollar, for an accumulated depreciation in two years of 11.9%, which was quite in line with the inflation of 14.% that was verified from August of 2000 to August of 2002, revealing that the real exchange rate did not suffer sudden movements/shifts that could harm any particular sector of the economy. I do not know why some of your officials state that when Baninter began to request liquidity assistance from the Central Bank in August of 2002, the exchange rate rose to 20, 23, or 26 to one, when in reality it was 18.46 to the dollar, which they use to uphold the absurd thesis that it was the &exchange crisis⁸ that detonated the bank crisis.

Don't forget, Mr. President, that you handed to me a Central Bank with barely US\$197 millions in Net International Reserves, which as you will not have forgotten was due to your decision not to adjust the prices of fuels in October of 1999, and the decision made by the authorities of the Central Bank to gradually consume the reserves existing at that moment up to August of 2000. The reserves fell by US\$350 millions from December of 1999 to August of 2000. In August of 2002, when Baninter began to request liquidity assistance, the Net International Reserves of the Central Bank were US\$546 millions, almost three times what you handed over to me.

As you see, Mr. President, the economic indicators that the Dominican economy presented during the first 8 months of 2002 were better than those you handed to me in August of 2000. The careful review of them will not allow any qualified analysts to deduce that these indicators, deriving from the anti-cyclical economic policy that we adopted in order to face the negative external shocks that we faced in 2001 and 2002, were the causes of the bank fraud that was discovered in 2003.

The crisis of Baninter, Bancrdito, and Banco Mercantil was not caused by the economic policy, but rather by practices that international experts categorize as frauds and administrative handlings totally foreign to established norms.

Allow me, with all due respect, Mr. President, to ask you the following question: If as you say, it was the supposed bad/wrong economic policy of my government that precipitated the crisis of Baninter, Bancrdito, and Banco Mercantil, why then didn't the rest of the country's banks also fail?

The answer to this question, for all international experts and multilateral financing agencies, is obvious. For all of them, the origin of the crisis was a fraud, nothing more. For that reason all have been disturbed and surprised by the strange hypothesis which you and some of your officials have presented.

I cannot let pass the opportunity to explain to you why in my government the decision was taken to save/safeguard the depositors, beyond the reasons advanced above by international experts and multilateral financing agencies, who make their statements on the basis of experience in the world when the collapse is located in a bank which is very/too large to collapse⁸ and the authorities fear the real possibility of contagion by the rest of the system, which would, in the absence of the rescue of the depositors, would cause the collapse of the system of payments and the arising of a large and prolonged recession in our country.

For years the different governments that we have had, including yours and mine, have struggled to encourage Dominicans to save and invest in this country. For years, on many occasions, the authorities of the Superintendence of Banks repeated to the holders of savings accounts and to depositors in the banking system, that the Dominican system was healthy and solid, that there was nothing to fear, statements which were made on the basis of the financial statements that the banks delivered to the supervisory authorities. In April of 2003, when the fraud was revealed, we had two options: to rescue or not to rescue the depositors who had believed in what the different governments, for years, had been telling them: that saving and depositing in our banks was safe. Your own Foundation, Mr. President, the Fundacin Global Democracia y Desarrollo, was among those Baninter depositors, with two current accounts, 1 savings account, and 64 financial certificates totaling RD\$119,132,136.98.

I did not hesitate for a single instant to recognize that the decision made by the monetary and financial authorities of my government was the correct one. I acknowledge that the way in which the depositors and owners of savings accounts were rescued, with titles and short term certificates, is a matter which is subject to debate and argument. But when one is faced with a risk of contagion as high as the one perceived by the monetary authorities and the IMF itself, there is not much room or time to theorize, while hundreds of thousands of depositors and savers throughout the entire system are waiting for signals to determine whether they should move their savings abroad or not.

The decision that was adopted constituted an exercise in justice and responsibility of State, even though aware of the negative political effects that this would cause my government and my political future, which at that moment enjoyed an ample advantage in popularity surveys. I was simply assuming the blame for all of the governments of the decade of the 1990s, mainly yours corresponding to 1996-2000, because they were incapable of setting the bases necessary to safeguard the sacred savings of the people.

I am not aware of a single banking crisis in the world that

has not had serious fiscal repercussions. Ours cost 21% of the GNP. Argentina's (1980) and Indonesia (1997) cost 55% of the GNP, China (1999) 47%, Jamaica (1995) 44%, Chile (1981) 42%, Thailand (1997) 35%, Macedonia (1993) 32%, Uruguay (1981) and Turkey (2000) 31%, Israel (1983) 30%, South Korea (1997) 28%, Japan (1992) 24%, Venezuela (1994) 22%, Ecuador (1998) 20%, and Mexico (1994) 19%. Why do they generate these fiscal costs? Because in the end, the risk of not rescuing the banks and/or the depositors is too high. In our case, the banks could not be rescued because the origin of the collapse was fraud. For that reason, the ones who were directly rescued were the depositors and savers.

President, you left me no other alternative than coming out in defense of my administration, pointing out to you relevant and inarguable aspects of the reports from all of the international experts contracted by the IMF and other multilateral organizations, who because of their nature and professionalism, maintain a totally independent attitude, without any political ties and without binding themselves to public positions, in contrast to some functionaries who in order to stand out and impress their Presidents, lead us to make statements lacking in foundation, instead of objectively and professionally informing us.

Mr. President, the banking crisis caused by the fraudulent activities of some private banks is an extremely serious subject and, therefore, it requires that all of us treat it with the degree of seriousness and depth that it deserves. This includes you as President of the Republic and myself as former President. The price that all of us Dominicans have had to pay for the fraud committed by private bankers has been enormous. Let us allow justice to do its work and let us avoid, with our statements, any disturbance of the transcendent work performed by one Power, which like the Judicial Power, must operate outside of political pressures.

Lastly, I invite you to reflect profoundly on this subject. If for reasons of which we are not aware it is uncomfortable for you to recognize in the fraud of the private bankers the only and true reason behind the banking crisis of 2003, evaluate whether silence constitutes a less irritating option for the country, than the presentation of hypotheses based on the criteria that everything bad is due to the previous government.

I exhort you to look ahead/forward, lending urgent attention to the serious problems which could be incubating in the national economy, due to an excessive and extemporaneous/untimely rigidity of the norms of the banking system, specifically in relation to the Regulation for the Evaluation of Assets, which is the fruit of impositions by the IMF, despite the enormous progress in matters of solvency, capitalization, and improvement of the mechanisms of governability which the national banking sector has experienced in the last two years.

I take advantage of this occasion to repeat to you that your government may always count on my support for the approval of all those reforms and measures which our country may require to face the challenges and opportunities that CAFTA-DR presents us, as well as the coherent initiatives which permit the solution of the problem of the Central Bank's debt, because so long as we do not face the root problem of the significant quasi-fiscal deficit, it will not be possible to guarantee the permanent of price stability. It seems to me that the role that the Legislative Power has played, in which the Dominican Revolutionary Party has a majority participation, approving all of the reforms which your government has submitted for its hearing, is a clear demonstration that for our party and for the undersigned, the country comes first before our party or private interests. For those purposes you can count on our support,

Yours very truly,

Hiplito Meja

14. (U) This report and others in the series are available on the classified SIPRNET at <http://www.state.gov/p/wha/santodomingo/> along with extensive other material.
HERTELL